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**SPECIFICATION FOR THE SECOND RURAL VITALITY REPORT**

**Second report for LATVIA**

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<b>PU</b>	Public	X
<b>PP</b>	Restricted to other programme participants (including the Commission	
<b>RE</b>	Restricted to a group specified by the consortium (including the Commission	
<b>CO</b>	Confidential, only for members of the consortium (including the Commission Services)	

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The project aims to establish a network of experts involved in agricultural policy analysis and rural development in the New Member States, in the Acceding Candidate Countries and in the countries of the Western Balkan. More detailed information on the project can be found at [www.agripolicy.net](http://www.agripolicy.net).

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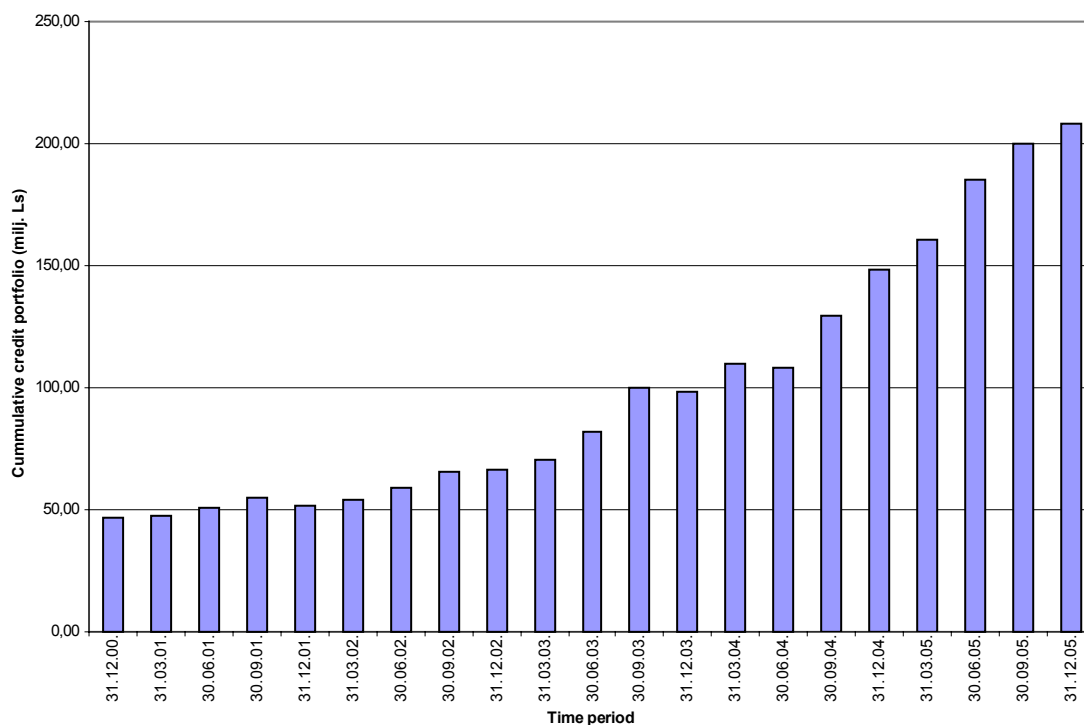
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# 1 Introduction and background

There is no available data based analysis differentiating short and medium/long term crediting in rural development/agriculture sector. Only qualitative (expert based) assessment could be performed to describe main tendencies and practices in a field.

There is rapidly developing share of agriculture related credit portfolio in Latvian commercial banking sector. Overall dynamics of commercial crediting for agriculture is represented in Chart 1.

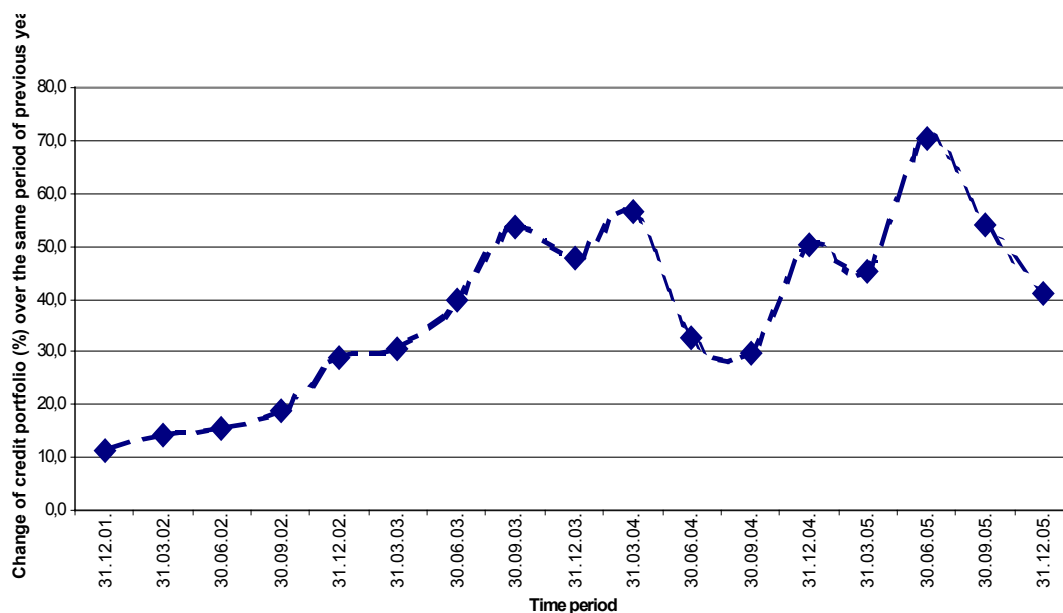
**Chart 1. Dynamics of cumulative credit portfolio (milj. Lats) in Latvian commercial banks.**



Source: Data - The Financial and Capital Market Commission; Calculations and representation – LSIAE.

**To assess tendencies and main factors influencing credit based financing** in the sector of agriculture there are provided data on change rates of agriculture related credits (cumulative portfolio) in Latvian commercial banks over time (Chart 2). There is evidence of important deviations from steady growth with noticeable increase of growth rate attributing to the end of year 2003 – beginning of 2004 and end of 2004 – beginning of 2005. These deviations mainly could be associated with periods of intensive absorption of pre-accession and structural funds of EU in Latvian agriculture sector. However partly these impacts are covered up also by institutional and structural changes in Latvian banking sector. Potentially some improvements in credit procedures shortening necessary time for arrangements caused shift of seasonal function, and consecutively calculations of change rate between same periods of different years ceases to be good estimate.

**Chart 2. Change rates of agriculture related credits (cumulative portfolio) in Latvian commercial banks over time.**



Source: Data - The Financial and Capital Market Commission; Calculations and representation – LSIAE.

**Main actors in credit financing of agriculture** in Latvia are several universal banks (to be mentioned A/S “Latvijas Unibanka”, A/S “Parekss banka”, A/S “Latvijas Krājbanka”, A/S “Hansabanka”). Comprehensive role in financing of the sector plays “VAS “Latvijas Hipotēku un zemes banka” (Mortgage and Land Bank of Latvia). Being a twofold bank – *development bank* and *commercial bank*, it implements the State Aide programmes and ensures that the State Aide is not used to gain commercial benefits. In order to develop the Bank’s operations further and use the existing capacity, the Public - Private Partnership (PPP) model is implemented by attracting private capital and keeping the implementation of the existing and future State Aide programmes under State control.

The Mortgage and Land Bank of Latvia that operates in accordance with PPP model is an effective instrument of the Government of Latvia for flexible implementation of the objectives of national economic development in its capacity of the Development Bank, but as a Commercial Bank it is an effective profit oriented bank that supports the Government of Latvia in achievement of the objectives of the national economic development.

While **growth rate of agriculture’s credit portfolio** remains positive and pretty high (as evident from Chart 2.) it decreased in second half of 2005. Partially this decrease could be associated with seasonal changes, but we don’t foresee return of the rate to the level of 60 – 70% per annum. As producing capacity of Latvian agriculture sector adequate to the available markets is nearly reached, supposedly there is reached also some “credit capacity” for the agriculture sector in Latvia.

**To characterise development of financial markets and economic environment** in Latvia, additionally there are provided data on changes of interest rates for long-term and short-term credits in Latvia (Table 1.) If in the year 2000 we observe higher interest rates for short-term credits, then since year 2002 rates for long-term credits exceed rates for short-term credits. It’s caused by changes in perception of safety of investments over different time horizons. Supposedly process of joining EU brings in business environment more uncertainties for distant future.

**Table 1.**

Year	Average weighted interest rate for commercial credits in Latvian banks	
	Long-term	Short-term
2000	10.3	12.1
2001	10.4	10.8
2002	8.5	7.5
2003	7.5	5.4
2004	9.2	7.5
2005	n.d.	n.d.

Source: CSB Latvia (Central Statistical Bureau of Latvia).

**Summarising above mentioned** there could be drawn a conclusion – in Latvia at the moment there persists well developed infrastructure for commercial and development financing of rural (mainly agriculture) sector.

## **2 Availability and performance of rural credit facilities**

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**To assist farmers and rural entrepreneurs** in finance and other knowledge-demanding issues there is established “The Latvian Rural Advisory and Training Centre” (LAAC). It serves as training and advisory institution for farmers and rural entrepreneurs.

The staff of LAAC is 220 employees. Status - non-profit limited company, owned by the State (99%) and the Farmers Federation (1%). Over 20 thousand farmers use services of the LAAC.

The National centre of LAAC at Ozolnieki includes Departments of:

- Agriculture,
- Farm Management and Financing,
- Training and Further Education,
- Information,
- Economy and Rural Development.

There are 26 local agricultural advisory offices (AAO) that offer services in agriculture in all 26 districts of Latvia.

**To provide more preferential financing** in support of **rural development** there is established set of specialised finance instruments. Some of them are not bank related, other are implemented through commercial banks. Brief overview of main instruments is reflected in Table 2. **To assess tendencies and main factors influencing credit based financing** in the sector of agriculture there are provided data on change rates of agriculture related credits (cumulative portfolio) in Latvian commercial banks over time (Chart 2). There is evidence of important deviations from steady growth with noticeable increase of growth rate attributing to the end of year 2003 – beginning of 2004 and end of 2004 – beginning of 2005. These deviations mainly could be associated with periods of intensive absorption of pre-accession and structural funds of EU in Latvian agriculture sector. However partly these impacts are covered up also by institutional and structural changes in Latvian banking sector. Potentially some improvements in credit procedures shortening necessary time for arrangements caused shift of seasonal function, and consecutively calculations of change rate between same periods of different years ceases to be good estimate.

**Table 2. Main preferential finance instruments for support of rural development**

	Main objective	General conditions	Financial instruments and specific conditions			Overall capacity or capital
			Credits	Other investments and guaranties	Technical assistance programs	
<b>Rural Development Fund</b>	To guarantee credits for rural development if borrower is in shortage with his own guaranties	For agriculture only		Guarantees for commercial credits in banks having partnership contract with the Fund. Co financing - 30 – 80% of total of the credit		
<b>Latvian Guarantee Agency</b>	To promote entrepreneurship, undertaking large part of the risk in case if prospective enterprise can't obtain the credit due to lacking of sufficient guaranties	For capital assets, buildings, machinery, as well investments in non-material assets, design, marketing, innovation		for 2 – 7 year period;  Co financing not exceeding 70% of total of the credit		
<b>Program for Support of Non-agricultural Entrepreneurship</b>	Promotion of economic development in rural area by support of non-agricultural entrepreneurship, improving infrastructure	Entrepreneurship which isn't related to agriculture	Max - 10 thous.. LVL (could be combined between different types of support)	For guaranties – 70% of total of the credit	For grants – max 30% of the eligible costs of the project if project implementation is in the region of the special development support status	7 milj. LVL
<b>Agriculture Long Term Investment Crediting Program</b>	To promote creation of sustainable and competitive farms in capital intensive branches of agriculture	New buildings for agricultural production and pre-processing, hydro technical constructions for fish farming, reconstruction of buildings for agricultural production and pre-processing, purchase of the equipment and land required for these projects	Depending on the branch of agriculture - 5 – 100 thous. LVL (at 7%) for period up to 20 years			24 milj LVL

	Main objective	General conditions	Financial instruments and specific conditions			Overall capacity or capital
			Credits	Other investments and guaranties	Technical assistance programs	
<b>Crediting Program for Purchase of Agricultural Land</b>	To promote functioning of the land market and more effective management of the agricultural land	Purchase of the agricultural land (non-agricultural land can't exceed 30% of total value of land, in total no more than 400 ha)	Long-term investment credits (at 4%) for period up to 20 years			2,5 milj. LVL
<b>Crediting Program for Rural Development Projects</b>	Promotion of development of entrepreneurship outside of major cities of Latvia (Riga, Daugavpils, Liepaja, Jelgava, Jurmala, Ventspils, Rezekne)	Can be granted only once to private persons for starting their business or to small businesses having not credits in their history up to the moment	Credits at 8.5 – 13% (fixed) rate not exceeding 2000 LVL, for period up to 18 month (for currant assets) or up to 12 years for other			
<b>Crediting Program for Small and Medium Enterprises</b>	For support of SME-s	Need guarantes in form of immovable, deposit, securities, transportation means, equipment, machinery, warranty etc.	150 – 300 thous. LVL at rates 2,75 – 6% + EURIBOR; for period up to 12 month (for currant assets) or up to 10 years for other			

### **3 Overview and prospects**

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Main sources for short-term credits are commercial banks. Quite widespread is also practice to provide short-term credits for agriculture making in-advance payments based on contracts between farmers and merchants, processors and manufacturers.

Main sources of medium-term/long-term credit are commercial banks as well above mentioned specialised finance facilities.